

1812



1931

**Economic Conditions
Governmental Finance
United States Securities**



New York, September, 1931.

The European Financial Situation

THE series of dramatic events precipitated in Europe in May by the difficulties involving the Credit Anstalt, Austria's leading bank, reached a new climax during the past month when the center of financial pressure moved from the Continent to London, bringing British financial troubles to a head and eventually forcing the downfall of the Labor Ministry and the appointment of a coalition government headed by Mr. MacDonald to deal with the emergency. When the financial crisis first broke out in Central Europe, London had stood as a bulwark of strength against the spread of the disorder. The Bank of England courageously extended a credit of approximately \$21,000,000 to the Austrian Government at a critical time when negotiations for a credit appeared to be breaking down, to the imminent peril of the entire banking structure of Central Europe, and later participated to the extent of \$25,000,000 with the Bank of France, the Federal reserve banks and the Bank for International Settlements in a joint credit of \$100,000,000 to the Reichsbank. As the crisis spread, however, London itself eventually became involved, and during the last three weeks of July was subjected to withdrawals of funds which reduced the gold holdings of the Bank of England by \$158,000,000 to \$649,000,000 (£133,000,000) on July 30, the lowest since November, 1929. Of these withdrawals, \$100,000,000 went to Paris, the remainder going to Amsterdam and Zurich. American banks refused as a matter of policy to take gold from London, although the rate of exchange would have made such transfers profitable.

In an effort to check this outflow of gold and attract funds to London, the Bank of England in July advanced its discount rate by two successive steps from $2\frac{1}{2}$ to $4\frac{1}{2}$ per cent without avail, and on August 1 announced that it had obtained a joint credit of \$250,000,000 from the Bank of France and the Federal reserve banks. Still the withdrawals continued, with the result that by the latter part of August a large proportion of the credit was reported to

have been used, with no indications of a subsidence of the drain. In the face of this emergency, the Labor Party in power was unable to agree on the drastic measures regarded as imperative in order to restore confidence both at home and abroad, and in consequence was forced to step down in favor of a coalition of all parties pledged to deal with the situation.

Causes of British Difficulties

Of the various influences combining to unsettle sterling, the most immediate has doubtless been nervousness induced by the general situation in Europe. It is known that London had substantial commitments in Germany, and apprehension as to the safety of these commitments has apparently led to concern on the part of foreigners as to the London position. It is significant that weakness in sterling first became pronounced at the time when the German situation was rendered most acute by the closing of the banks. The fact that most of the gold lost by London went to Paris has already been referred to. Since the Bank of France has not been a party to this movement, having on the contrary participated in a credit to support the pound, the conclusion is that the movement has been on the initiative of private banks and other lenders having large balances in London, and who, despite the great plethora of funds in the French money market, have found reasons for wishing to have their money nearer home.

Besides this immediate cause, however, other difficulties of more fundamental character have also been factors in the situation. Ever since the war British foreign trade has suffered from two important handicaps, (1), a tendency on the part of certain foreign markets which have been large buyers of important lines of British goods to develop their home production, as in the case of textiles in the Far East, and (2), the relatively high cost of British goods, due partly to failure to thoroughly modernize industrial equipment and methods and partly to comparatively high

labor costs attributable to trade union resistance to readjustment of wages in line with lower prices.

Origin of the wage difficulty dates back to the different financial policies pursued by Great Britain and rival nations after the war. At that time Great Britain's principal Continental competitors found their exchanges so heavily depreciated as to make restoration to parity out of the question, hence most of them simply accepted the current levels of exchange as permanent and adjusted their currency systems accordingly. Great Britain, however, with a much less depreciated exchange and with the prestige of London as an international money center to safeguard, declined to follow this policy of repudiation and elected the more difficult task of restoring the value of the currency to par. Such a policy necessarily involved a decline in the price level, which, if unaccompanied by a corresponding reduction in money incomes,—that is, wages and salaries—, was certain to lay a heavy burden of cost upon British industry. Although a reduction of money incomes in keeping with a decline of prices would not have involved any sacrifice of real income or lowering of the standard of living of British workers, the attitude of British labor has been consistently opposed to any concessions in this regard, with the inevitable result that production costs have been kept up and British prices have tended to be higher than those of competing goods. The fact that British labor is so strongly unionized has been one important reason for this inelasticity in the wage level, and the effect of the dole has likewise been to prevent necessary wage adjustments to meet altered conditions by diminishing the compelling influence of unemployment.

Because of these adverse influences, Great Britain's export industries have been in a more or less chronic state of depression ever since the war, and of course the difficulties have been vastly increased by the depression and further decline of prices of the past year. As the number of unemployed has grown, the burden of the dole upon the budget has been increased, while the revenues have been reduced. Though the need for economy has been imperative, the British people, like most other people in similar circumstances, have displayed a natural reluctance to undertake retrenchment in a serious way, and there has been much talk of such expedients as tariffs or central bank action to flood the money market with credit as substitutes for economy, in hope that by these methods prices could be induced to rise and prosperity restored without going through the unpleasant process of deflation.

The Economy Committee Report

Just what the outcome of such attempts to readjust upward while the rest of the world is readjusting downward would be on a nation as dependent upon foreign trade as Great Britain is problematical. Events have been moving too swiftly to permit the experiment. Due to the mounting cost of the social services and the shrinking revenues, the outlook for the budget has been viewed with increasing concern ever since the beginning of the Summer. Finally, at the beginning of August, came the report of the Economy Committee, appointed in March by the Parliament to make a study of the problem of balancing the national finances in 1932-3.

This report declared bluntly that a continuation of present policies would lead to disaster and called for drastic reductions in expenditures to avoid an estimated deficit of £120,000,000 (approximately \$580,000,000). In arriving at this estimate the committee figures upon a probable increase of £62,000,000 in expenditure and a probable decrease of £57,000,000, or thereabouts, in revenue. Included in the increased expenditures are £10,000,000 additional borrowing for the Road Fund and an estimated increase of £12,000,000 in contributions by the Government to unemployment relief under the regular unemployment insurance scheme. Over and above these, however, are the heavy borrowings of the Unemployment Fund from the Treasury to provide for unemployment benefits not covered by the regular insurance. By the end of the current financial year it is expected that the total of such borrowing will exceed £100,000,000, with a further increase of £40,000,000 estimated on the present scheme for 1932. These the committee characterizes as irrecoverable advances, which it denounces as "adding to the national debt to relieve current revenue charges" and therefore "opposed to the principles of sound finance hitherto accepted without question."

To meet the deficit, the report recommends economies aggregating £96,500,000, of which no less than £66,500,000 should be saved out of the cost of unemployment insurance. Other suggested economies include nearly £14,000,000 on education, and £10,600,000 on "development," chiefly on schemes financed out of the Road Fund, while from £20,000,000 to £30,000,000 additional is hoped for from additional taxation.

This report, containing so much plain speaking, came as rather a shock to British credit, and appearing at a time of general unsettlement, gave additional impetus to the tendency for funds to leave England. And the movement, once started, has proved cumulative, as such movements usually do, fear feeding upon

fear, until remedial measures of sufficient importance are adopted to restore confidence.

The Basis for Confidence

Such measures the British have now given evidence of a determination to adopt. The new Government is counted on to submit a program of extensive economies, including a substantial cut in the unemployment insurance, to Parliament when it reconvenes September 8. Though it is not expected that these reforms will solve all of Great Britain's difficulties they should be ample to assure budgetary equilibrium and thus meet the present crisis. The formation of the coalition Government, following the split in the Labor Party over the issue of unemployment insurance is evidence of the country's intention to put the finances on a sound basis. In view of the recent experience with Germany, it is not surprising that the public should be quick to take alarm at any suggestion of difficulty in other money markets. The situation, however, as between Germany and Great Britain is not analogous. London for years has been the chief depository of the world's surplus of short-term credits, and is an old hand at the international banking business with a prestige built up over more than a century of sound finance. It has billions of dollars of foreign investments yielding a substantial annual income, so that it has but to reduce temporarily the volume of its new overseas investments to set up a current of funds to the home market. And, finally, it has neither internal nor external political complications as serious to contend with as those which were so large a factor in precipitating and prolonging the German crisis.

Already the steps taken have had a decided effect upon sentiment abroad. Confidence in British credit has been restored. As we go to press, the announcement has just been made of the arrangement by a group of American banks and banking houses to extend a one-year credit of \$200,000,000 to the British Government, and of arrangements being made in the French market for one-year credits and loans in the aggregate amount of approximately \$200,000,000. The conclusion of loans of this size should establish sterling exchange against any possible onslaught, and is evidence to the world that the financial markets do not propose that anything shall happen to the pound.

The Situation in Germany

The political and financial situation in Germany is more encouraging. The failure of the referendum brought about by the extremist parties to overthrow the moderate coalition in Prussia was regarded as an endorsement also

of the government of the Reich and has strengthened the hand of Premier Bruening. Approximately 60 per cent of the population of Germany lives in Prussia, hence the importance attached to this vote in determining the political tendencies of the country. The fact, however, that nearly 10,000,000 voters, or approximately 37 per cent of the qualified electorate of Prussia voted for the referendum and consequently against the moderate regime is disquieting evidence of the strength of the discontented element.

Evidence of lessening financial strain in Germany appeared in the reopening early in August of the German banks, including the Darmstaedter und Nationalbank, for full domestic business, following a three weeks' period of partially suspended payments. The resumption of banking activities took place with surprisingly little disturbance, and provided a most reassuring demonstration of self discipline on the part of the German people and of confidence in their banking system.

Meantime, the steps taken to check the flight of capital from the mark to other currencies were likewise proving more effective. Bankers in London and New York, holding the principal short-term credits in Germany, continued in effect their informal day-to-day agreement voluntarily entered into during July not to recall these credits. At the same time, a rigid foreign exchange control instituted by the German government checked the export of German capital by German subjects and prevented withdrawals of short-term credits by foreign bankers not participating in the voluntary agreement.

Thus, gradually, the situation both internally and externally, has shown a relaxation of tension. Improvement in the position of the Reichsbank was indicated by a rise in the reserve ratio to 41.5 on August 22, against 35.8 at the low point on July 15. On August 12, the Reichsbank took official cognizance of general betterment in the situation by lowering its regular rediscount rate from the peak figure of 15 per cent to 10 per cent, and its collateral loan rate from 20 to 15 per cent.

The Question of Short-Term Credits

The question of what to do about the \$1,250,000,000 of bank credits estimated to be still remaining in Germany has remained most difficult to solve. Obviously, Germany is incapable of repaying any such large amount of funds within a limited period. Nevertheless, there was always the danger that some lenders would become panicky and start to withdraw funds, thus precipitating a stampede which could only result in a complete breakdown of the system of exchange and loss to everyone. So long as this possibility hung over Germany

as a constant threat there could be little hope of restoring confidence necessary for re-establishing her banking and credit system on a sound and secure basis.

To attempt the conversion of these short-term credits into long-term credits by means of a large bond issue would be impracticable under existing conditions. Hence, there has been no alternative but for Germany's short-term creditors to frankly recognize that payment of a major part of these credits must be postponed for the time being, and to take steps to deal with the situation in an orderly way with a view to safeguarding so far as possible the interests of both debtors and creditors. It will be realized, of course, that the great majority of these credits have been advanced to banks and concerns in Germany of excellent standing, and that individually most of them are perfectly good and doubtless could be liquidated promptly. It is only in the mass that they have become temporarily uncollectible, hence the necessity of setting up some kind of plan whereby everyone agrees to leave them undisturbed until the situation becomes more normal. While the informal day-to-day agreement of bankers relieved the tension for the moment, it was too uncertain and too limited in scope to be considered more than a temporary makeshift. Some more formal plan was needed which would provide definitely for a moratorium and include all the interested parties.

Accordingly, negotiations were entered into between the German authorities and representatives of the foreign creditors. Subsequently, these negotiations were conducted through the medium of the international committee of inquiry set up in Basle to study the German situation. As a result, an agreement was finally concluded in the latter part of August providing for an extension of these credits for a period of six months. This agreement was announced in connection with the general report of the committee dealing with the German situation.

Report of the Basle Committee of Inquiry

This committee of inquiry was appointed in accordance with the provisions of the following resolution of the London Conference in July:

The conference recommends that the Bank for International Settlements should be invited to set up without delay a committee of representatives nominated by the governors of the central banks interested to inquire into the immediate further credit needs of Germany and to study the possibilities of converting a portion of the short-term credits into long-term credits.

The committee named consisted of the following distinguished bankers and economists: Messrs. Layton, Great Britain; Moreau,

France; Melchior, Germany; Beneduce, Italy; Francqui, Belgium; Bindschedler, Switzerland; Tanaka, Japan; Rydbek, Sweden; de Groot, Holland; and Albert H. Wiggin, of the Chase National Bank of New York, Chairman.

The report of the committee, which was made public on August 20, is an exceedingly interesting document. It contains a careful analysis of the fundamental causes of the German crisis and of the conditions deemed by the committee as necessary to recovery.

It begins by tracing the rapid growth of German foreign indebtedness since 1924, and explains how payments to foreign creditors during those years have not been made out of Germany's own resources, but only by means of additional money borrowed abroad. It points out the weakness of the situation arising from the fact that so large a portion of these borrowings was on short-term, and was used to do the work of long-term money.

Following this preliminary explanation, the report turns to the immediate situation and calculates that during the first seven months of this year the withdrawals of foreign credits, plus selling by foreigners of long-term investments in Germany, plus investments by Germans abroad, resulted in withdrawals of approximately 3,500,000,000 marks from Germany, thus precipitating the crisis. It reaches the conclusion that Germany will continue under a severe strain until a part at least of the circulating capital that has been withdrawn from the German economy has been replaced.

The report then goes on to consider possible ways in which Germany might secure this capital by her own efforts. Taking up first the question of the further sale of some of Germany's foreign assets in the form of bank balances and short-term investments, and long-term investments such as branch factories and the like, the committee concludes that most of these assets are either needed in current trade or are not readily realizable, and that therefore a plan of assistance based upon their mobilization and sale would not be practicable to assist in Germany's recovery.

Considering the possibility that Germany might acquire the needed capital through a program of drastically reducing her imports, while at the same time making every effort to increase exports, the committee points out the serious dislocation in the economic life of the country, as well as the accentuation of intense competition in world markets, certain to result from such a plan, and rejects this, too, as an unsatisfactory solution of the problem.

Thus, the committee was forced to the following two definite conclusions:

1. That the existing volume of Germany's foreign credits should be maintained and

2. That part, at all events, of the capital which has been withdrawn should be replaced from foreign sources.

The report warns, however, against the further import of foreign short-term capital, and concludes that the only solution is a long-term loan, which will both provide additional credit and convert a part of the short-dated debt into long-time obligations.

To obtain such a long-term loan, however, Germany must be able to inspire the confidence of investors. The report proceeds to examine the German position from an investment banking angle and finds much that is favorable. It quotes approvingly the recorded opinion of the London Conference that the lack of confidence in Germany which caused the withdrawals that have precipitated the present crisis "is not justified by the economic situation of the country," and supports this view by reference to the rapid recovery of German exports in recent years and the demonstrated ability on the part of Germany to convert an import trade balance into an export balance. As to the question of public finances, the report points out that while these have been subject to criticism in the past, the present government has given proof of its determination to put Germany on a sound basis.

But two fundamental difficulties remain, declares the report, which must be cleared up if Germany's credit status is to appeal to foreign investors. The first is the political risk involved. Relations between Germany and her neighbors must be firmly established on a basis of sympathetic cooperation and mutual confidence if Germany's credit is to be assured. The second relates to the external obligations of Germany, and here the report makes some highly significant statements. It declares that so long as Germany's external obligations are such as to involve either a continuous and cumulative increase in her foreign debt or, alternatively, a disproportion between her exports and imports on such scale as to threaten the economic prosperity of other countries, the investor is unlikely to regard the situation as stable or permanent. It expresses the opinion that the emergency extension of the short-term credits should not be regarded as a solution of the problem but merely as a means of gaining time during which steps for re-establishing the credit of Germany can be taken, and it calls on the governments of the world to realize their responsibilities and take the needed measures to restore confidence. And finally, in one of its concluding paragraphs, it sums up its views of the situation with the following decidedly pointed remarks:

We think it essential that before the period of prolongation of credits recommended by the London Conference comes to an end they should give to

the world assurance that international political relations are established on the basis of mutual confidence which is the *sine qua non* of economic recovery and that the international payments to be made by Germany will not be such as to imperil the maintenance of her financial stability.

Implications of the Report

These are strong statements. Doubtless different readers will interpret them differently. It is clear, however, that the committee regards a realistic settlement of the reparations question as an indispensable prerequisite of German economic recovery. The committee places the responsibility directly on the governments of the world to see that this is done, and warns that there is no time to lose.

There can be no disagreement with the views of the committee as to the desirability of an early settlement of this question on an economic basis. If, however, the present period of confusion and depression should be considered inopportune for settling so complex a question as that of German capacity to pay under normal conditions, the world at least needs assurance at the earliest possible moment that the breathing spell accorded by the suspension of international debts will be adequate to give time either for reconsideration of these debts or for the restoration of economic conditions to levels which will render them less burdensome.

When the Hoover moratorium was first proposed its purpose was stated to be "to give time to permit debtor governments to recover their national prosperity." It would appear miraculous, however, for such recovery to take place within a year. Two months already of the period of grace have elapsed, and soon people will be concerned with the question as to what is to happen after July 1, 1932. If nothing is done the world at that time will be in danger of a more difficult situation than it was in June this year when the moratorium was first proposed. It is inconceivable that governments will permit the situation to drift in this way. Nevertheless, the uncertainty that exists is casting a blight over business everywhere. So long as no one knows what is going to happen in Europe, business cannot be expected to go ahead with confident plans for the future, and this hesitancy is one of the factors tending to depress the commodity markets.

So far as the ordinary processes of economic readjustment are concerned, there is evidence that a great deal of progress is being made. Production is being gradually brought into line with consumption. Prices have been drastically reduced in many lines to levels that ought to encourage buying. Stocks of goods other than certain foods and raw materials are not excessive. What is needed now above all

else is a restoration of confidence, and this can come only through the removal of what is, in our opinion, the chief restraining influence, namely, apprehension as to the ultimate outcome of conditions in Europe. If the political situation could be improved, particularly as regards the Franco-German relations, and business relieved from concern over the possibility of a premature attempt to force resumption of debt payments, we believe that these would be the most constructive steps that could be taken towards improving the public psychology and bringing the depression to an end.

General Business Conditions

The domestic business situation has shown no marked change during the past month. Wholesale trade has shown an irregular pick-up in preparation for the Fall retail trade, but conditions in the heavier industries, iron and steel, automobiles, building, and dependent lines continue generally sluggish. While the immediate wants of the people are furnishing a steady flow of business in articles of common every-day necessity, the feeling of uncertainty which still pervades the business world has continued to have a restraining influence upon the longer term constructive undertakings from which the heavier industries derive their principal support.

In order to go ahead with important projects, business must have either confidence in the future or the incentive of unusually low costs. At the present time business is facing a great many difficulties which tend to impair confidence. We have already referred to the uncertainty which exists regarding the European situation, which we regard as the most formidable obstacle to revival of confidence at the present time. In addition, there are many disturbing influences in the domestic situation, such as unemployment, the low prices for staple commodities, and banking difficulties, which must inevitably exert a restraining influence on trade and sentiment.

There is no question but that prices of many commodities are rapidly getting to levels which constitute a strong inducement to buyers. The movement, however, is not uniformly distributed, which means that some groups of producers gain at the expense of other groups and trade is thereby impaired. An outstanding feature of the situation, and one which suggests the natural way out of the present business impasse, is the notable response generally accorded by the public to offers of goods for sale at real bargain prices. Where real values are available there appears to be little hesitancy in buying. In our opinion, business is likely to gain more by endeavoring to make goods so cheap that people will

want to buy, than through "Buy Now" campaigns and similar efforts to urge them to purchase against their will. If bargains are what people want, the thing to do is to make bargains as universal as possible, so that not only will the retail buyer be attracted, but anyone who has the slightest idea of going ahead with any program of expansion will be forced to conclude that now is an advantageous time to do it. Eventually, it will be by this reduction of cost that the depression will be overcome, hence the sooner all parties engaged in the productive processes realize this and cooperate fully to this end, the better.

Manufacturing Activity

The steel industry declined steadily from the Spring peak in March to July, when ingot production was only 1,876,149 tons, or 34 per cent of rated capacity, and the lowest daily average since December, 1921. Weekly estimates since July show that the decline has been checked, the percentage for the successive weeks of August being 31, 32, 33 and 32, according to the Dow Jones reports, compared with 33 in the last week in July. With forward buying long at a standstill and no one willing to carry supplies, these figures suggest a bottom. After vacation shutdowns and tapering off, the automobile manufacturers will want more steel in preparation for introduction of new models at the year-end, and projects requiring structural steel, in hand or in the making, supply a supporting backlog of orders. The automobile industry reduced its output during August to the lowest since last Fall, and will enter the Autumn with sub-normal stocks of cars, sales having exceeded output in July, and probably in August also.

Daily average building contracts awarded in August, up to the 22nd, were, except for last December and January, the smallest since the compilation of the present series of figures, covering 37 states, was begun in 1925.

As in preceding months, operations are well sustained in the so-called light industries, offering goods to retail at low prices. Production of wearing apparel for Fall sale has been active, and the July output of shoes is estimated at 28,500,000 pairs compared with 24,120,000 a year ago. The rayon industry, which had a busy Spring during which stocks were substantially reduced, has climbed back after its between-seasons' period to nearly capacity production. The boom in wool goods has raised consumption and machinery activity in some departments to higher levels, after allowance for the season, than in 1928-9, although reductions in prices of cloths now offered for Spring are evidence that the market strength has not extended everywhere.

Seasonal expansion in cotton goods buying has been delayed by uncertainty as to values, but mills at the beginning of the month had the smallest stocks of cloth on hand since 1927, and Fall needs are not covered.

Outlook for Wheat

The wheat outlook is somewhat brighter as a result of recent developments which include more definite evidence that the Russian crop is smaller than last year, when the yield per acre was exceptionally high. This year a considerably reduced yield has cut down the crop despite the larger acreage; the latest report of the U. S. Department of Agriculture on the subject says that while the Southern Ukraine will supply grain for early export, elsewhere the yields are poor and the harvest wet, while in parts of Siberia drought has caused complete failure. Meanwhile intimations, still unconfirmed, that greater requirement for domestic consumption will reduce the allotment for export, and even that rationing of food may be abandoned, have appeared repeatedly in the press. Whatever may be the truth of the matter at present, such is the direction in which Russia's policy must eventually turn.

In some of the European countries the harvest has been wet and the quality of the wheat is poor. Rice crops in the Far East are very poor, a factor increasing demands for wheat. Further evidence that the law of supply and demand is at work restoring the balance is the estimate by a leading statistician that the Winter wheat acreage of the United States will be reduced 16 per cent, supported by backwardness of preparations to date. Such curtailment is inevitable at present prices, and follows considerable reductions in acreage in United States Spring wheat, Canada, Argentina and Australia this year; it does not relieve present pressure, but is hopeful for the future, and an advance of even 10 cents a bushel in wheat later on would markedly help the business situation.

The Cotton Situation

The government estimate on August 8 predicting a cotton crop this year of 15,584,000 bales has been received everywhere with consternation. Such a crop assures the textile industry of abundant and cheap raw material, but at the expense of the producers, who are important consumers of textiles and of other things; and it is clearly much greater than the desirable median that would benefit producers and consumers alike.

If the government prediction is realized,—and the weather during August, a critical month, has not pointed to much change in the coming September estimate,—the cotton grower this year will fail to recover his costs,

and will have expended his labor without acquiring purchasing power in return. The estimated crop is larger than the world consumption of American cotton in any season save 1926-7, when the record crop of all time was produced. Since then competition of foreign growths has become increasingly important, and by reason of that competition and of world depression consumption of American cotton for the season ended July 31st last was reduced to 11,100,000 bales. A surplus has been accumulating since the season of 1928-9, and the carryover into the present season was about 9,000,000 bales, pointing to a total supply of 24,500,000, the largest ever available.

This year consumption is likely to improve, and American cotton should regain much of the ground recently lost to foreign growths. Prices have dropped to the lowest figures since the season of 1899-1900. In some of the large Southern interior markets middling cotton, the standard grade, has sold around 5½ cents a pound, a quotation from which further deductions must be made to arrive at the price to the farmer and the price of grades below middling.

Cotton growing costs are difficult to determine and vary widely, but studies by the Department of Agriculture place the average in 1930 at 16 cents per pound, where yields between 101 and 180 pounds per acre were obtained, and 13 cents for yields between 180 and 260 pounds. This year's estimated yield is 185.8. Undoubtedly all costs are much reduced this year, through cheaper labor and lessened cash expenditure of every kind. Cotton growers have raised a larger proportion of their food than in other years. Such economies will be most helpful in withstanding the effects of the drastic price decline.

There is no mystery about the crop. It is a "weather freak." Unprofitable prices of the previous season effected a reduction of 10 per cent in the acreage, and 39 per cent less commercial fertilizer was used. But the weather thus far has been the most favorable for promoting plant growth and suppressing the boll weevil since that insect spread over the belt during the war years and immediately after.

Revised Profits Tabulation

Since the publication last month of a preliminary tabulation of industrial corporation profits for the first half year some two hundred additional reports have been issued, and we now present a revised tabulation on the following page of 555 companies. Combined net profits of the group, after deducting all charges but before dividends, amounted to approximately \$406,000,000, as compared with \$846,000,000 in the corresponding period of

INDUSTRIAL CORPORATION PROFITS FOR FIRST HALF YEAR

Net Profits Are Shown After Depreciation, Interest, Taxes, and Other Charges and Reserves, but Before Dividends.

Net Worth Includes Book Value of Outstanding Preferred and Common Stock and Surplus Account at Beginning of Each Year.

(In Thousands of Dollars)

No.	Industry	Net Profits Half Year		Per Cent Change	Net Worth January 1		Per Cent Change	Annual Rate of Re- turn Per Cent	
		1930	1931		1930	1931		1930	1931
7	Amusements	\$18,404	\$4,695	-74.5	\$287,065	\$355,722	+23.9	12.8	2.6
16	Apparel	1,850	776	-58.1	145,351	122,472	-15.7	2.5	1.3
1	Auto-General Motors	104,885	85,865	-18.1	954,476	966,802	+ 1.3	22.0	17.4
18	Auto-Other	23,588	4,429	-81.2	737,498	655,014	-11.2	6.4	1.4
38	Auto Accessories	31,443	13,256	-57.8	481,311	459,067	- 4.6	13.1	5.8
10	Aviation	D-5,422	911	.....	244,544	230,225	- 5.9	.....	0.8
9	Baking	21,324	18,696	-12.3	330,757	330,419	- 0.1	12.9	11.3
18	Building Materials	10,793	6,138	-43.1	380,300	385,789	+ 1.4	5.7	3.2
23	Chemicals	68,622	49,771	-27.5	1,051,738	1,154,831	+ 9.8	13.0	8.6
8	Coal Mining	1,876	1,622	-13.5	123,937	124,462	+ 0.4	3.0	2.6
11	Drugs and Sundries.....	33,561	32,492	- 3.2	359,784	399,156	+10.9	18.7	16.3
13	Electrical Equipment	40,228	21,635	-46.2	852,167	902,050	+ 5.9	9.4	4.8
29	Food Products-Misc.	70,106	51,089	-27.1	837,060	861,014	+ 2.9	16.8	11.9
20	Household Goods	8,434	4,545	-46.1	273,501	269,238	- 5.2	6.2	3.5
1	Iron and Steel-U. S. Steel..	67,905	14,156	-79.2	1,919,313	2,059,089	+ 7.3	7.1	1.3
32	Iron and Steel-Other.....	64,399	1,299	-98.0	2,021,716	2,003,524	- 0.9	6.4	0.1
31	Machinery	24,178	4,623	-80.9	425,225	451,158	+ 6.1	11.4	2.0
31	Merchandising	19,291	22,917	+18.8*	850,953	795,140	- 6.6	4.5	5.8
23	Mining-Non-ferrous	25,706	3,629	-85.9	820,746	788,699	- 3.9	6.3	0.9
7	Office Equipment	11,264	4,867	-56.9	187,580	187,237	- 0.2	12.0	5.2
13	Paper Products	6,255	4,471	-28.5	299,003	318,465	+ 6.5	4.2	2.8
33	Petroleum	72,344	D-6,897	.....	2,277,357	2,500,573	+ 9.8	6.4	.....
10	Printing and Publishing....	19,241	12,055	-37.3	149,450	149,930	+ 0.4	25.7	16.1
14	Railway Equipment	31,326	4,518	-85.6	818,232	868,992	+ 6.2	7.7	1.0
6	Realty	8,327	2,997	-64.0	145,966	141,348	- 3.2	11.4	4.2
9	Restaurant Chains	4,150	3,631	-12.5	78,569	80,011	+ 1.8	10.6	9.1
9	Rubber Mfg.	3,203	1,696	-47.0	604,042	491,981	-18.6	1.1	0.7
5	Shoes	9,863	6,763	-31.4	182,330	179,888	- 1.3	10.8	7.5
15	Textiles	2,613	1,834	-29.8	216,448	205,278	- 5.2	2.4	1.8
9	Tobacco (Cigars)	4,782	3,339	-30.2	131,561	126,445	- 3.9	7.3	5.3
81	Miscellaneous	41,789	24,462	-41.5	1,063,529	1,002,928	- 5.7	7.9	4.9
555	TOTAL	\$846,233	\$406,270	-52.0	\$19,251,509	\$19,553,967	+ 1.6	8.8	4.2

*Gain largely due to two companies.

D-Deficit.

1930 and \$1,216,000,000 in 1928, representing declines of 52 and 67 per cent respectively. There were 173 companies or 31 per cent of the total that reported deficits this year aggregating \$120,399,000, while in 1930 there were 78 companies or 14 per cent having deficits of \$45,180,000, which have been deducted in arriving at the totals.

Annual rate of profits return is also shown in the table by major industrial groups and averaged 4.2 per cent on the \$19,554,000,000 net worth at the beginning of this year as compared with 8.8 per cent in 1930 and 14.8 in 1929.

The decline in profits this year was somewhat greater than was indicated by our preliminary tabulation because of the later publication of a considerable number of very unfavorable reports, including some twenty companies in the oil industry, which suffered severely during the period from overproduction of crude petroleum and falling prices. Without the oil group, which changed from a net profit of \$72,344,000 to a net deficit of \$6,-

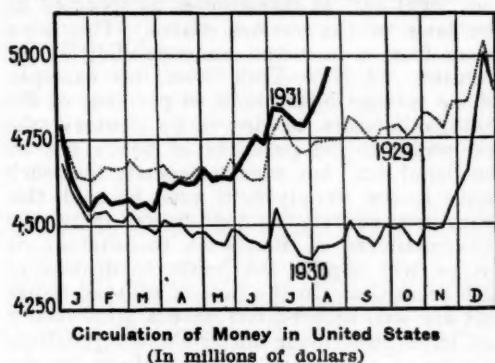
897,000, the decline in profits of all other companies as compared with last year would be 47 instead of 52 per cent.

Money and Banking

The banking position tightened somewhat in the early part of August. However, a sharp increase in the volume of Federal reserve bank credit outstanding kept money in comfortable supply, and at times during the month the New York City banks had a substantial excess of reserves above requirements. No changes in money rates have occurred, though a slight seasonal firmness on time loans and commercial paper running into the Autumn, when money is normally a little dearer, is to be noted.

Explanation of the changed position must be sought elsewhere than in business demand for loans, which has been extremely slack, for either commercial or security market purposes. (The principal cause has been a continued rise in money in circulation, due not to

trade requirements but to banking difficulties, which increase currency withdrawals and cause hoarding by individuals, and lead banks to hold larger amounts of till money.



The accompanying chart shows circulation this year with comparisons for 1930 and 1929. The total on August 26 was about \$250,000,000 higher than at the same time in 1929, although, according to the indexes of business and prices, the trade turnover in dollars in August 1929 was much greater than during the month just past. Except over the year-end periods when holiday demands and other annual disbursements cause a seasonal rise in currency, the present total is the highest reached since 1926. The increase in use of checks in this country is a factor constantly tending to diminish the amount of currency in use, which emphasizes the abnormal character of the present situation.

Movements of Foreign Funds

A second cause of the tightening in the banking position has been the transfer of a large volume of foreign funds employed in this country from use in the markets to idleness in the Federal reserve banks. Most foreign countries keep funds in the United States in order to facilitate disbursements and receipts which their trade and the service of their obligations constantly require. As a rule these funds are kept at work in order to earn an interest return, and are therefore at the use of the market. However, during recent weeks a considerable volume of these funds has been withdrawn from use. Upon maturity of the bills in which they were placed the proceeds were deposited in the Federal reserve banks, whose deposits for foreign account, usually negligible, rose to a high point of \$183,000,000 on August 26.

While for a time considered puzzling, the explanation of this transfer is in reality quite simple. France, a country which has long maintained particularly large balances in New York, lays a tax of 1 per cent upon funds in

use abroad. When bill rates in New York dropped below 1 per cent, such employment of funds immediately became unprofitable, and bills maturing were not replaced. Bank balances, it is true, are likewise taxable at the same rate, but it has been suggested that the French banks are anticipating a possible repeal of the tax upon deposits carried in the Reserve banks and receiving no interest. Otherwise, under present conditions, a loss on short term funds kept in this market will be incurred.

Additions to Reserve bank credit necessitated by these conditions amounted to \$232,000,000 between August 5 and 26 and the amount in use during the month was the highest since the seasonal demands over the last year-end. This credit was supplied in part through additional purchases of U. S. Government securities, raising the System's holdings to approximately the highest point in its history. As purchases of government securities constitute the method by which the Reserve banks make credit available upon their own initiative, this is an effective answer to the charge sometimes made that Reserve bank policy is not forceful enough in the direction of pumping credit into the market as a means of overcoming the depression. The fact is that the amount of Reserve bank credit supplied during most of this year has exceeded the requirements of business, and the excess was left idle in the form of surplus reserves of the member banks. Reserves of New York City banks were largely in excess of requirements during the first five weeks of the year, during the greater part of March, again from the end of May to the first week of August, and at intervals again during the month.

Changes in Member Bank Position

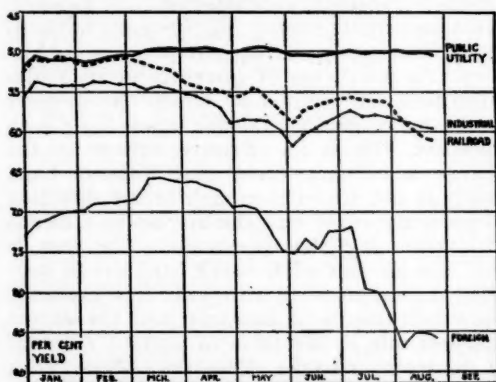
During the month of August gold holdings continued to increase, imports totaling \$52,000,000; the largest quantity was shipped by Japan, which sent \$25,000,000. These imports were in part offset by an increase of \$16,000,000 in gold held here under earmark for foreign account, which presumably is connected with the French transfers described.

Reduction of loans by the reporting member banks has continued. Loans on securities dropped \$117,000,000 during the four weeks ended August 19, and were the lowest since the early Autumn of 1927. The item of "all other" loans, after increasing during July due to larger holdings of acceptances, which are included under this heading, has again declined, dropping \$72,000,000 during the same four weeks and is now \$595,000,000 under a year ago. Brokers' loans made by the New York City member banks, at the low point reached during the month, were the lowest in

any year since 1923, but rose slightly in the last two weeks.

The Bond Market

Reflecting the continued timidity of capital for long-term investment, the bond market has been very thin during the month, and in certain groups liquidation has been under way for which support has been lacking. As a result price indexes have declined to new lows for the year and for the depression period. The market has continued highly selective. Prices of highest-rated bonds, while not wholly immune from the general weakness, have been relatively firm. Among the various groups liquidation has principally occurred in those reporting unsatisfactory earnings, and in obligations of some foreign countries.



Bond Yields by Groups, 1931

The accompanying chart showing corporate and foreign bond yields, with the scale inverted so that the lines move in the same direction as prices, illustrates these varying price movements. The indexes are those of Moody's Investors Service, and forty bonds are included in each group. Public utility bonds have declined little, and hold well above the low point at the beginning of the year. In all other groups the major trend has been downward, and most emphatically during the past month in the rails. For this divergence the respective earnings statements fully account. Net earnings of 26 utility companies thus far reported for the first half year show an increase of 2 per cent over the same period of 1930. By contrast, net operating income of the Class 1 railroads amounted to approximately \$239,000,000 as compared with \$377,000,000 a year ago, a decline of 35 per cent. Return on property investment was at an annual rate of only 2.15 per cent.

Situation in Railway Bonds

It is generally recognized that investors have been perturbed by the possibility that

large amounts of railroad bonds may have to be sold by savings banks because of not covering their fixed charges by required margins this year, and therefore being removed from the "legal list" of investments as specified by the laws of the various states. This view arises from a mistaken understanding of the statutes. In New York State, for example, whose savings banks hold 44 per cent of the savings deposits of the entire country, the law prohibits the purchase of bonds not on the "legal list," but does not specify that such bonds as are already held must be sold, this being left entirely to the discretion of the Superintendent of Banks as to whether or not he will require the banks to dispose of such securities. In the case of railroad issues that are well secured and have a good record but have been made ineligible for purchase because of conditions brought about by the business depression, it is unlikely that the savings banks would be either required or inclined to sell them out at a sacrifice.

It seems safe to say that the selling of rail bonds by frightened investors has been too indiscriminate to be entirely wise. The present dangers to railway credit, and the difficulties that may result if the situation should continue long unchanged, are obvious, which is the main reason why it probably will not so continue. The roads have reduced their costs, and when traffic increases again their net income will rise rapidly. To bridge over the emergency their chief reliance as a group is that the decision soon to be rendered on the petition for rate increases will be favorable, while among individual roads there are many in a strong position with respect to cash and collateral holdings which will carry them safely through any likely duration of the depression. That the obligations of such roads have declined with others is an evidence of indiscriminate and general unsettlement which is alarming to potential buyers, but has no bearing on intrinsic values.

Foreign Issues

Further weakness has appeared in certain foreign bonds during the month. The deferment of payment for Chilean bonds announced during July, reasons for which were discussed in the last issue of this Letter, has been followed by an announcement with respect to the remaining five months of this year that "it is not possible during this period to effect the service of the external funded debt." The announcement further stated:

The Government is engaged in reducing budgetary expenses for the coming year to an amount not in excess of \$85,166,500, which will permit it to deposit in Chilean pesos an amount equivalent to interest on all its obligation and eventually to deposit as well the equivalent of sinking fund payments on these debts if any improvement in the general business situation

should occur of such a nature as to diminish the shortage which it has been necessary to take into account in calculating the income of the coming year.

The Government has also decided to attain in as short a time as possible the re-establishment of the balance of payments by means of the Exchange Control Commission, which is already operating, and through customs tariffs and other measures tending to the same end.

Colombian bonds have been under pressure of liquidation upon press reports that a moratorium was being considered, which Dr. Olaya Herrera, president of the Republic, has denied in the following terms:

Movement in favor of moratorium never attained importance. The government feels certain of its ability to attend to the strict fulfillment of its financial obligations abroad and it reaffirms its unchangeable policy in this respect. The senate by a vote of 36 against two has approved the following resolution: Colombian Senate declares that the decision of the government to maintain the precise and punctual fulfillment of the service of the country's debts is in the best interests of the country. National revenues are improving.

Argentine and Brazilian issues likewise have been weak, while the fall in German and Austrian issues has stopped, reflecting the easing of the tension in those countries.

Institutional Market

As has been true over a long period, activities of institutions, principally banks, have played the most important part in the bond market, and during August have taken the form of selling. In three weeks ended August 19 the reporting member banks of the Federal reserve system reduced their investments by \$147,000,000. The reduction has been occasioned in part by demands on the banks in connection with the increase in circulation previously described, and has occurred in holdings of U. S. governments as well as of other securities, the respective declines being \$102,000,000 and \$45,000,000. Federal Government financing during the month has added \$80,000,000 to the short-term public debt, and a long-term issue is an early probability though the Treasury's intentions had not been made public at this writing.

The explanation of the bond market decline is not to be found in money rates, the spread between short-term rates and bond yields of course having widened during the month; nor in new issues to be absorbed, the volume of such offerings having been the smallest since just after the crash in 1929. It is another reflection of subnormal business, and of the tendency to overdiscount difficulties by getting funds out of every situation in which even remote prospects of trouble are detected. Even highest-grade corporate bonds do not fully escape the effects of general unsettlement, but with money easy and the supply of such bonds diminished by retirements and subnormal capital flotations, they occupy a preferred position and the outlook for them continues to be good.

The MacMillan Report

An important recent publication dealing with the broad subject of the gold standard, finance and their relations to industry, is the report of the MacMillan Committee, which was created in 1929 by the MacDonald Labor Government of Great Britain. The terms of reference were as follows:

To inquire into banking, finance and credit, paying regard to the factors, both internal and international, which govern their operation; and to make recommendations calculated to enable these agencies to promote the development of trade and commerce and the employment of labour.

The inquiry undoubtedly had its origin in current criticism of the banking business and the gold standard, coming from parties favorable to having banking, or at least the central banking institution, taken over by the Government, with a view to more effective regulation of credit in the interest of industry, stability of prices, etc. Notwithstanding some apprehensions in business circles over the proposal for an inquiry, the personnel of the Committee appointed by the Government was accepted as fairly representative. It was headed by a professional man of high repute, Lord MacMillan, formerly Lord Advocate of Scotland, and included two well-known London bankers, (Messrs. Reginald McKenna and R. H. Brand), two eminent university economists, (Gregory of the University of London and Keynes of Cambridge), two important personages in organized labor, a representative of the Treasury, an outstanding figure in the British Cooperative Societies and several business men of prominence.

Neither the bankers nor the economists would be considered as of the "standpat" type, and the whole body was regarded as representative of liberal economic views and business policies.

No Radical Change Proposed in Money or Banking

The report is an official volume of 300 pages, which, whether the reader agrees with every opinion or not, must be considered a thorough and enlightening treatment of the subject. It does not recommend any radical change in the Bank of England, on the contrary, commends the management as having been governed by a high sense of responsibility to the public interest. No change in the monetary standard is proposed, and full recognition is given to the services of the gold standard in international trade and financial relations. The report says:

There is, perhaps, no more important object within the field of human technique than that the world as a whole should achieve a sound and scientific monetary system. But there can be little hope of progress at an early date for the monetary system of the world as a whole, except as the result of a process of evolution starting from the historic gold standard.

Causes of the World Depression

The Committee does not accept the theory that the fall of prices and the business depression have been due to inadequate supplies of gold, but holds that the abnormal distribution of gold between the countries since the war has exerted an influence similar to that which an actual scarcity might be expected to exert; also, that if aggregate supplies had been larger the distribution under the war and post-war conditions probably would have been about the same. It recognizes the non-monetary factors in the situation. The following quotation gives a concise analysis of the complex situation:

It seems to us equally clear that the economic difficulties of the post-war decade are primarily due, not to any wanton misbehaviour on the part of the monetary factors themselves, but to unusually large and rapid changes on the part of what are rightly described as non-monetary phenomena; these non-monetary factors again themselves producing monetary changes. In particular, war and post-war non-monetary causes led to the great and unwanted flow of gold to the United States from which such vital consequences have ensued. For example, in the foregoing summary of events we have attributed great importance (i) to the unusual instability in the demand for capital resulting from the losses and interruptions consequent on the War, (ii) to the changes in the established relationships between debtor and creditor countries consequent on the War debts, (iii) to the rapidity of technical changes in manufacture and agriculture, (iv) to the shifting character of demand resulting in a want of balance between the demand and supply of services as against manufactured products, of new types of manufacture as against old, and of manufacture as a whole as against agriculture, (v) to the rigidity of wage-rates, (vi) to the growth of tariffs, (vii) to the embarrassments of Budgets, and (viii) to violent changes in speculative activity in New York and elsewhere.

Urges Cooperation Between Banking Systems

Nor does the Committee manifest any alarm regarding future supplies of gold. The main theme of the report is that the Central Banks of the principal countries, by the practice of continuing conference and cooperation, should be able to exercise a control over the supply of credit that "will keep a steady pace for the international system as a whole," which it holds to be the important matter. It believes that "alternate excesses of enthusiasm and depression may be avoided and the demand for the new output of instruments of production and other forms of capital in the world at large kept in better equilibrium with the proportion of income which is currently available for such purposes—neither in excess nor in defect."

In other words, it holds that development and construction work should be kept in pace with the growth of actual savings and not be unduly stimulated at times by the use of credit, which results in instability. It believes that this requires a common policy among Central banks, which are now the ultimate sources of bank credit in all countries.

The Committee is satisfied that it is within the power of Central banks collectively "for some time to come, if not indefinitely, to insure that the available quantity of monetary gold would not operate as a limitation on the use of a wise discretion as to the volume of currency and bank credit to be created by the gold standard countries as a whole."

In support of this view it argues that with gold no longer in hand-to-hand circulation, and with currency issues centralized in the semi-official Central banks, the only real need for gold is in the settlement of international balances, and that the size of these balances can be to a great extent controlled by a common Central bank policy. Such extraordinary movements of gold as those to the United States during and since the war, and in Europe in recent months, do not occur in the course of normal international relations, and there is no necessity to provide for them if the world is going to maintain peaceful and orderly relations. On the other hand, if the world is going to indulge in outbreaks of war from time to time, it is useless to plan for stability either in credit or price conditions.

The doctrine of the Committee is that all countries are alike interested in maintaining an equilibrium and stability in trade and the use of credit. None has anything to gain by piling up large balances against others, which must be settled in gold. This does not mean that a country which is actually developing faster than others may not acquire a corresponding increase in its gold reserves, but actual development is not rapid enough to be a disturbing influence. Such a boom in construction and speculation as occurred in the United States from 1925 to 1929 is an example of expansion harmful to the country in which it occurs and disturbing credit conditions all over the world. The Committee believes that cooperative policies by the Central banks can control such expansion. Undoubtedly it is true that no such movements of gold as those to the United States would have been possible but for the extraordinary conditions arising from the war.

The Report of the MacMillan Committee is an informative, unprejudiced, document, and since it comes from a body of twelve men selected by the present Labor Government of England it cannot be reasonably said to have been prepared in the interest of capitalism or the banking business. The men who have signed it are from many walks of life, but they were agreed upon a single purpose, to-wit: the organization of world banking with a view to the maintenance of greater stability to industry and employment. This idea has been developing among economists and bankers in recent years and is illustrated by the

cooperation of bankers of many countries in giving support to the German economic system at the present time.

One Point of Difference

On one point there will be differences of opinion over the Report. The main report seems to advance the view that it is within the power of the Central banks, acting upon a common policy, to lift the world out of the present depression by a liberal use of credit. The separate notes of individual members indicate that this is questioned even within the Committee. To lift the business world out of a state of depression is a different task from that of keeping it on a steady course of balanced prosperity. Such an upheaval and disruption of relationships as that caused by the great war may result in derangements which cannot be corrected by mere adaptations of general banking policy. There are other factors in the business organization which may have to make adaptations of their own. For example: when Russia, from being the source of thirty per cent of the world's imports of wheat, which was its average contribution in the five years preceding the war, ceased to supply any, and the world adapted itself to this situation by increasing production elsewhere, it is evident that the reappearance of Russia as an exporter, on something approaching the pre-war scale, requires readjustments outside of the banking business. And when world sugar production is raised in like manner from about 18,000,000 tons per annum before the war to 28,000,000 tons in 1930, the situation calls for something more than a change in banking policy. When all countries adopt a general policy of stimulating home production for the purpose of becoming economically independent of each other, banking policy alone will not prevent disorder in trade. In short, world affairs cannot be wholly regulated by the Central banks. The foregoing quotation from the MacMillan Report intimates that other disorders have been experienced.

It will be agreed that liberal banking policies everywhere will help to stimulate business courage and enterprise, but confidence once shaken is not easily restored. The Reserve banks and United States Treasury now hold about 41 per cent of the world's stock of monetary gold. The discount rate of the New York Reserve Bank is the lowest in the world, made so with the purpose of attracting borrowers, or in some way moving the reserves into use. It is striking evidence, not of a scarcity of gold in the world, but of disorder in world finance, that the discount rate of the New York Reserve Bank should be $1\frac{1}{2}$ per cent, of the Bank of France 2 per cent, of the Bank of

England $4\frac{1}{2}$, and the Reichsbank 10 per cent, at the same time. Eliminate political and social agitation, allow ordinary business considerations to rule, and no such differences would exist.

The gold standard has nothing to do with them, except that the gold basis for currency affords a ready means of transferring capital. Normally it aids distribution of capital from countries which have it in abundance to countries where it is needed, thus promoting the general state of world welfare, but, of course, the same facilities can be used to withdraw capital if the lenders or investors are moved to such action.

Value of International Relations

There are people who think the remedy for such international disorders is in curtailing international relations. It may be argued that if all international intercourse was ended all international troubles would cease. That, however, must be regarded as an impossible solution, in view of the facilities of communication and transportation existing today. It cannot be doubted that the way of civilization and social progress is along the path of better understanding, higher organization and more advantageous exchange of services between all the peoples inhabiting different parts of the earth. All can have a higher standard of living by working and trading together than any group could have if isolated from the others. Therefore their common task is to promote helpful and harmonious intercourse.

It has been said in critical descriptions of the present situation that Paris loaned money to London at 3 per cent, London loaned it to Berlin at 6 per cent and Berlin loaned it to Russia at yet higher rates. This conveys the idea that the same money or credit passed all the way around, whereas the truth, of course, is that borrowing and lending between different money markets and in connection with business between different countries is always going on. The spread between the rates named is abnormal, but that there are rate differences between money markets is not abnormal. They illustrate adaptation to credit conditions, and show how the flow of capital tends to overcome unfavorable conditions and thus promote development and trade. Political problems have made the rates what they are.

The Clearing Process of Settlements

What the MacMillan Committee says of the lessening use of gold in actual settlements, and practical discontinuance of its use except in international settlements, is true and of great importance. When paper currency was issued by numerous private banking institutions, it was considered necessary for such banks to carry reserves large enough to duly impress

the public with their ability to meet any demands upon them. Since paper money issues are confined almost wholly to Central banks, which are practically State institutions, this necessity no longer exists. All of the Central banks of Europe suspended gold payments during the war, but this was known to be for the purpose of protecting their gold reserves and affording them greater freedom in lending support to their governments during the war. The Bank of England, under the new gold standard act, is not required to redeem its notes in gold in response to all demands, but only in 400 ounce fine bars, having a value of about \$8,000 each, and for the purpose of maintaining the parity of the foreign exchanges. The new law governing redemption by the Bank of France is similar. There is not the slightest probability that any demand for gold in preference to other lawful currency ever will arise in the United States. The Federal reserve notes, which are the only form of currency now increasing, are obligations of the United States Treasury.

It is, therefore, an erroneous conception of the use of gold in the modern exchanges to speak of the entire body of world trade or world credit as resting upon, or depending upon, the gold reserves. The picture of a vast inverted pyramid resting upon an apex of gold is not a true one. Normal trade is what the word indicates, an exchange of goods and services, and for the most part settles itself. This is illustrated by our internal trade. Each section of our country ships out to the markets the products which it has for sale, and thereby creates credits in the banking centers, against which it draws in payment for what it owes or buys from the rest of the country or the outside world. In the long run these accounts practically balance, requiring insignificant movements of money and, so far as internal payments are concerned, practically no gold. The present demoralization of industry, trade and prices is due to unbalanced production, a result of the war, and not to any sudden change in the aggregate supply of gold in the world.

Trade Settlements in the United States

The retail trade and business of this country is handled by currency of various kinds, issued under authority of our laws, and nominally redeemable in gold, but this redemption is as unnecessary for internal purposes here as in Great Britain or France. This currency is a convenience of trade, and fluctuations in the volume occur through the Reserve banks, in conformity with the needs of trade.

A still more important medium of exchange exists in our check system. The checks drawn upon the numerous banks meet daily in the clearing houses, of which, at the date of the

latest report of the Comptroller of the Currency, there were 191 in the country, and offset and cancel themselves—a continuous process, from day to day—because trade in the last analysis is an exchange of services. The debtor banks in the daily settlements give checks on the Federal reserve bank of the district. The balances may run one way on one day and another way the next day, but in the long run practically settle themselves. The aggregate of settlements through the clearing houses in 1929 was \$726,884,632,547.

Thus checks drawn and received within a reserve district are cleared and cancelled through the clearing houses and reserve bank of the district. Checks drawn upon banks in districts other than the one in which they are received are cleared through what is known as the Gold Settlement Fund, which is maintained under charge of the Federal Reserve Board, in Washington. This is the agency through which all transfers and settlements between Reserve banks, and Reserve banks and the United States Government, are made.

The Gold Settlement Fund

The Reserve banks are bankers to the Government. All the revenues, proceeds of loans and other income of the Treasury pass through them and the Treasury's disbursements likewise. The Gold Settlement Fund is the connecting link of the entire system of internal payments. All of the Reserve banks contribute gold to this Fund, approximately in proportion to their volume of business. Each Reserve bank at the close of business daily sends to the Reserve Board a list of the items which it is charging to the Fund (checks on other Reserve banks or the Treasury) and thus the final clearing for the country is effected. It is wholly a bookkeeping process, although, as stated, each Reserve bank keeps enough gold in the Fund to amply cover its debit balances. But the gold is not segregated or shifted about from day to day. Like the deposits of a bank, it is one fund, the books showing from day to day each Reserve bank's share of it. The Federal Reserve Board's report for the year 1929, the year of the largest payments, shows the highest amount of gold in the Gold Settlement Fund at any date during the year to have been \$689,000,000, and the lowest amount \$511,000,000. The highest amount in the Fund was equal to about one-sixth of the aggregate gold holdings of the Reserve banks and the Treasury in that year, but the highest actual debit balance in one day was \$76,578,000, and the average daily balance in the year 1929 was only \$24,799,000. Here is an authoritative showing of the part which gold played in the business of the United States in the greatest business year in its history, and incidentally it may be mentioned that

the United States does not far from one-half of the business done in the world.

The Function of the Gold Standard

Somebody may be moved to ask, in view of the above showing, what service the gold standard renders and what need there is for it at all. The answer is that while the gold standard plays no more obvious part in the internal trade of other countries than it does in the internal trade of the United States, it links the monetary systems of all countries together and gives them a common basis for prices and financial operations. The currencies of all countries by having fixed relations to gold have fixed relations to each other and a given sum or price in the money of one country always means a certain sum or price in the currencies of all gold standard countries, subject to an exchange charge, which usually is less than the cost of shipping gold. This is the service of the gold standard to world trade and intercourse. Furthermore, it renders a stabilizing service to the internal trade of each country by attaching its monetary and price system to that of the rest of the world.

The MacMillan Committee says only what is generally endorsed by economists the world over when it lays down the principle that the function of gold is not that of supporting the vast structure of trade and credit in the world, (which is supported by commodity and property values), but as an acceptable means of settling the international balances. Moreover, there is growing recognition of the fact that the more nearly the trade of the world is kept in balanced relations the better it will be for price stability and general prosperity, and that the Central banks by acting together may exercise an influence to this end.

The Bank for International Settlements

The development of the clearing system in the several countries, and particularly the operations through the Gold Settlement Fund at Washington, by which the relations of all the Reserve banks are finally settled by book-keeping methods, have prompted the establishment of the Bank for International Settlements in Switzerland, primarily for distributing the reparation payments with the least disturbance in international finance. This institution, planned for clearing purposes, already is playing an important part in international payments, as its promoters hoped it might do. In a growing way it is serving as a clearing house or gold settlement fund and helping the world to become accustomed to the idea that large shipments of gold to and from are unnecessary, and moreover, that the legal requirement of gold reserves in strict proportion to the amount of all business done

in the world—beyond any use in the settlement of balances—also is unnecessary.

To sum up the conclusions of the MacMillan Committee, a world monetary and banking system is in the process of forming, as the natural result of the growing volume of international trade and financial transactions. The evolution of a common standard of value for nearly all monetary systems has brought them into close relations, and the time has come for a greater degree of cooperation in the control of credit, which is the chief factor of instability in the system. With this instability under control, the movements of gold will become of relatively small proportions and the problem of gold distribution and increasing reserves postponed indefinitely.

Efficiency in the Use of Gold

It is something to ponder over that the Bank of England, with gold reserves today less than \$700,000,000, is clearing more international business, and rendering more international aid to business, than the banking and currency systems of the United States and France together, although the gold holdings of these two countries aggregate over \$7,000,000,000. These figures afford a convincing demonstration that something other than a lack of gold in the world is responsible for the present disordered world situation.

The banking authorities of the United States and France have not been responsible for the unbalanced situation. They have offered no inducements for an inflow of gold, but as creditor countries the tide has flowed to them as a result of disturbed trade conditions. From the beginning of 1929 to August 15, 1931, two years seven and one-half months, the stock of monetary gold held by the United States Reserve banks and the Treasury increased from \$3,746,000,000 to \$4,620,000,000 and the holdings of the Bank of France increased from \$1,253,000,000 to \$2,295,000,000, an aggregate increase for the two countries of \$1,916,000,000. In the 7½ months of 1931 to August 15th, the United States gained \$396,000,000 and France \$195,000,000, a total for the two countries of \$591,000,000. This is enough to show that aggregate world supply is one thing and world distribution quite another. Both countries have far more than they need for their reserve requirements.

What can be done to accomplish distribution? Gold moves from country to country upon the initiative of private business, but at present the business instinct values safety above opportunities for profit. Political and social disorders which menace the security of investments are the dominating influence. When they are brought under control the distribution of gold will occur in the usual manner.

Combined Statement of the Banks of the First National Group in Minneapolis

as at June 30, 1931

RESOURCES

Loans and Discounts	\$ 59,152,540.68
Overdrafts	14,012.11
U. S. Govt. Securities	20,180,042.54
Other Bonds & Securities	26,734,522.48
Bank Buildings	1,166,500.00
Furniture & Fixtures	123,510.88
Customers' Acceptance Liability (Less Anticipations)	836,053.17
Bankers, Acceptances Purchased	2,427,911.41
Interest Earned but not Collected	431,541.36
Cash on Hand & Due from Banks	43,127,085.67
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	\$154,193,720.30

LIABILITIES

Capital Stock	\$ 7,500,000.00
Surplus	6,081,000.00
Undivided Profits	839,537.36
Reserve for Interest, Expenses and Taxes	456,706.81
Interest Collected but not Earned	239,823.20
Circulation	2,001,000.00
Letters of Credit and Acceptances	836,053.17
DEPOSITS	136,239,599.76
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	\$154,193,720.30

Affiliated with

FIRST BANK STOCK CORPORATION



FIRST NATIONAL GROUP



ST. ANTHONY FALLS OFFICE
East Hennepin at 4th Street

WEST BROADWAY OFFICE
West Broadway at Emerson

NORTH SIDE OFFICE
Washington at West Broadway

HENNEPIN STATE BANK
Washington at Hennepin

FIRST NATIONAL BANK
THE OLDEST BANK IN MINNEAPOLIS-ORGANIZED 1864

FIRST MINNEAPOLIS TRUST COMPANY
ORGANIZED 1888

FIRST SECURITIES CORPORATION

Affiliated with

MINNEHAHA NATIONAL BANK
27th Avenue South at Lake

PRODUCE STATE BANK
1st Avenue North at Seventh Street

BLOOMINGTON-LAKE NATIONAL BANK
Bloomington at Lake



FIRST BANK STOCK CORPORATION

